



Investment Office

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

(916) 795-3400

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AGENDA ITEM 10b(1)

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Institutional Investor Response to Market Conditions
- II. PROGRAM:** Global Equity – Corporate Governance
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

Executive Summary

Background

The recent conditions in the global markets have demonstrated the need for significant changes to the existing structures of regulation, market operation, information availability and accountability. As this situation has evolved, it has become apparent that institutional investors in general, and public pension funds in particular, need to be involved in shaping the changes that will surely be forthcoming. To this end, CalPERS and CalSTRS have partnered together, along with many other public pension plans, to begin the construction of a coherent position statement that outlines our concerns and ideas. A meeting was held in Washington D.C. on December 11th to discuss the situation and form the base outline of the document that will present a shared position for the participating funds. This meeting constituted a continuation of the work being done by CalSTRS and CalPERS to collect thoughts and perspectives from other public plans.

Participation

The participants in the meeting were: Eric Baggesen, CalPERS; Anne Sheehan, CalSTRS; Meredith Williams and Greg Smith, Colorado; Melissa Moye, Maryland STO; Maureen Madden, New York Common; Mike McCauley, Florida; Michael

Musuraca, NYCERS; Meredith Miller, Connecticut STO; Shelley Smith and Sally Choi, LACERS; Gail Hanson, Wisconsin; Carol Drake, Ohio; George Wong and Luke Bierman, New York Common; Michael Perez and Erika Tiedge, LA Fire and Police. The meeting also included prior SEC Commissioner Roel Campos, Senior Counsel of the House Financial Services Committee Lawranne Stewart and Damon Silver, Member of the Congressional Oversight Panel established by the Emergency Economic Stabilization Act. Also participating were staff members from the Council of Institutional Investors, John Stanton from Hogan & Hartson, Tom Lussier and Leigh Snell from LGVA.

Meeting Topics

A significant portion of the meeting was allocated to discussion with Stewart, Campos and Silver to identify the current regulatory and legislative environment. The main insights are:

- There is great support for the concept of creating a “systemic risk regulator”. Systemic risk appears to be defined as the threat to the overall financial system from the failure of an intermediary. There is no clarity regarding how this new regulatory capability would be organized, endowed with authority or resourced.
- The SEC is viewed as having been significantly weakened by the lack of the agency’s “presence” in the events taking place over the past year or more. The Federal Reserve and Treasury appear to have been much more engaged in attempting to work through the issues.
- There are high levels of disagreement on the relative merits of “principles” versus “rules” based regulation.
- Significant questions are being raised about the potential behavior of the Government as a shareowner in the companies accessing public capital. It is very unsure how the different aspects of corporate governance may be impacted.
- The attachment of traditional corporate governance items (executive compensation, golden parachutes, etc) to the various rescue programs is not seen as weakening the concept that these items should apply to all public equity issuers.
- A long term perspective needs to be reattached to both investment and corporate management. There are differences of opinion regarding topics such as mark to market accounting’s impact on the time perspective.

- Reform needs to be done on a global basis to be really meaningful as the issues underlying the market problems in the U.S. extend to the global capital markets.

Next Steps

The group was able to agree on a variety of next steps to be taken. There is a shared belief that institutional investors need to have a unified posture going into the supercharged environment for change and reform that presently exists.

- A background statement will be formed that speaks to the reasons why the investor group is engaged on these topics. This statement will reflect some of the impacts that are being experienced by the group along with statement regarding the importance of these institutional investors to overall economy. Among these impacts are:
 - A decline in the funded ratios
 - Liquidity constraints
 - Great uncertainty regarding asset allocation assumptions
 - Serious concern for the ability of sponsoring entities to meet their retirement and healthcare funding contributions
- Listing of the principle topics of concern where reform appears to be needed. This listing needs to be at a high level and distilled to the primary considerations. In asking for ideas from a number of informed parties, CalPERS collected literally dozens of items. To create a coherent message, the final listing needs to be constrained to a small number of the most important concepts. Tentative topics are:
 - Transparency – All financial instruments and their attendant attributes need to be visible to the regulators and the market. Transparency should also extend to trading activity and all accounting information.
 - Systemic Risk – In addition to the concept that systemic risk derives from an entity whose failure could compromise market function, another source of systemic risk is a market without any balance of buyers and sellers. When homogenous behavior takes hold of the market, prices can move wildly and result in extreme valuations with great implications.
 - Investor Protection & Corporate Governance – Investors need a strong, uncompromised voice with a mandate to create the most equitable environment based on responsible behavior and accountability. For U.S. investors, the SEC has held this role.

- Rational regulation – The current regulatory model is highly complex and based on the type of entity (bank, broker, insurance, etc). A problem with this model is that many entities participate in the same financial instruments but have very different regulatory requirements.
- Mark to Market – This accounting treatment has been at the heart of many debates and is linked to the investment time horizon issue.
- Global Coordination – For any reform to be effective there needs to be a degree of cooperation and coordination. This concept needs to urge convergence at the highest standard.

The listing of topics and perspective statement will be compiled and sent to the investor group for their input. Upon final determination of this information set, a dissemination and engagement process will be formulated to carry the messages to the appropriate regulatory and political audiences. The dissemination activity should start early in 2009.

V. STRATEGIC PLAN:

This item will further the following goals of CalPERS' Strategic Plan:

- Goal VIII. Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.
- Goal IX. Achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

Costs associated with implementing strategies to address market reform as a result of the current financial market crisis are contained within the Investment Office budget.

Bill McGrew
Portfolio Manager
Corporate Governance

Eric Baggesen
Senior Investment Officer
Global Equity

Anne Stausboll
Interim Chief Investment Officer